Supreme Court, U.S.
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No. 01-

IN THE

Supreme Court of the United States

MID-ISLAND HOSPITAL, INC. and
OFFICIAL COMMITTEE OF UNSECURED CREDITORS
OF MID-ISLAND HOSPITAL, INC.,

Petitioners,

v.

EMPIRE BLUE CROSS AND BLUE SHIELD,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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50 pgs

QUESTION PRESENTED

Section 541(a) of the Bankruptcy Code provides that property of the estate includes all legal or equitable interests of the debtor as of the commencement of the case. Section 541(a)(6) of the Bankruptcy Code provides that property of the estate includes proceeds, product, offspring, rents or profit of or from property of the estate. In the instant case, The United States Court of Appeals for the Second Circuit found that the Debtor had a property interest in certain Withholdings retained by Blue Cross pursuant to statute but paradoxically held that interest, if any, earned on the Withholdings was not property of the Debtor's estate.

The question presented is whether the United States Court of Appeals for the Second Circuit erred by affirming, on wholly different grounds, the decision of the District Court for the Eastern District of New York which, in turn, affirmed the oral decision of Judge Marvin A. Holland, former Bankruptcy Judge of the Bankruptcy Court for the Eastern District of New York, which granted summary judgment in favor of Blue Cross by finding that the Plaintiffs were not entitled to interest earned on the Withholdings which constituted property of the estate under 11 U.S.C. § 541.

CORPORATE DISCLOSURE STATEMENT

Petitioner, Mid-Island Hospital, Inc., has no parent corporation and no publicly held company owns 10% or more of its stock.

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Mid-Island Hospital, Inc. (the "Hospital," or the "Debtor") and the Official Committee of Unsecured Creditors (the "Committee" and collectively with the Debtor, the "Petitioners" or the "Plaintiffs") respectfully submit this Petition for a Writ of Certiorari to review the decision of Chief Judge Walker and Circuit Judges Calabresi and Pooler of the United States Court of Appeals for the Second Circuit dated January 15, 2002 (the "Order"), in which they affirmed the decision of Judge Arthur D. Spatt of the United States District Court, Eastern District of New York, dated September 23, 2000 which affirmed the March 17, 2000 oral decision of the Honorable Marvin A. Holland, former United States Bankruptcy Judge of the United States Bankruptcy Court for the Eastern District of New York, which granted the motion of Empire Blue Cross and Blue Shield ("Blue Cross" or "Defendant") for summary judgment dismissing the complaint of the Plaintiffs in the above-captioned adversary proceeding.

CITATIONS OF LOWER COURT DECISIONS

The District Court's opinion (per Spatt, DJ) affirming the granting of summary judgment is published at *In re Mid-Island Hosp., Inc.*, 254 B.R. 71 (E.D.N.Y. 2000). (Appendix B). The Court of Appeal's decision (per Walker, CJ joined by Pooler and Calabresi, JJ.) affirming the District Court's decision is published at *In re Mid-Island Hosp., Inc.*, 276 F.3d 123 (2d Cir. 2002). (Appendix A).

STATEMENT OF JURISDICTION

The order of the United States Court of Appeals for the Second Circuit was decided on January 15, 2002.

Thereafter, the Petitioners filed a Petition for Rehearing which was denied by the Court of Appeals pursuant to an order dated March 7, 2002. (Appendix C).

The Petitioners invoke this Court's jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT STATUTES AND PROVISIONS

Section 541(a)(1) of the Bankruptcy Code provides:

> (a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such an estate is comprised of all of the following, wherever located and by whomever held:
>
> > (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

Section 541(a)(6) of the Bankruptcy Code provides:

> (6) Proceeds, product, offspring, rents or profit of or from property of the estate except such as are earnings from services performed by an individual debtor after the commencement of the case.

10 NYCRR 91.4(i) provides:

> If any hospital shall fail to timely submit checks in accordance with this section, the hospital shall have 30 days from the date of receipt of

notification to provide the required checks. Failure to submit the checks within the 30-day time period shall result in the withholding of 10 percent of the hospital's payments from all major third-party payors regulated pursuant to subpart 86-1 of this Title until such time as the required checks are received by the pool administrator.

PRELIMINARY STATEMENT

As set forth herein, the complaint demands the payment to the Debtor (and thereby, to the Debtor's creditors) of interest earned or proceeds derived from funds of the Debtor held by Blue Cross pursuant to the terms of a New York State statute defined hereinafter as the Withholding Regulation. Pursuant to the Withholding Regulation, Blue Cross held the substantial sum of approximately $4.5 million of the Debtor's money (the "Withholdings") for a period of over seven years. During this time, Blue Cross held the money in its operating account and enjoyed the use and benefits of the Debtor's money. Upon the eventual turnover of the funds, the Plaintiffs requested, through their complaint, that the Bankruptcy Court direct Blue Cross to turn over to the Debtor, for the benefit of its unsecured creditors, any interest , profits or proceeds derived from these funds pursuant to Bankruptcy Code Sections 541(a)(1) and 541(a)(6) and various state law causes of action. The Bankruptcy Court granted summary judgment dismissing the complaint at the inception of the proceedings and prior to any discovery based on the finding that there was no requirement to pay interest. On appeal, the District Court affirmed the Bankruptcy Order based on a finding that the Withholdings were not property of the estate under the Bankruptcy Code. Upon further appeal, the Second Circuit affirmed the District Court decision on completely different

grounds finding that the Withholdings were, indeed, property of the estate, but that there was no requirement for the payment of interest.

Thus, the three courts which have ruled on this matter have based their rulings on a different legal analysis. Consequently, the Plaintiffs have not had an opportunity to seek an appeal of the final legal reasoning of the Court of Appeals which was inconsistent with the legal findings of the District Court.

The Plaintiffs respectfully submit that the Court of Appeals erred in its decision which is based on the legal conclusion that Blue Cross was not required to pay or earn interest on the Withholdings. The Plaintiffs assert that despite the lack of legal obligation to earn interest on the Withholdings, should the facts show that Blue Cross did, in fact, earn interest on the Withholdings, such interest would constitute property of the estate under the applicable provisions of the Bankruptcy Code. Accordingly, summary judgment should not have been granted since a factual determination should have been made as to whether there actually was interest earned or proceeds derived from the maintenance of the $4.5 million Withholdings fund during the time it was in the custody of Blue Cross.

STATEMENT OF THE CASE AND FACTS

On June 20, 1997 (the "Filing Date"), the Hospital filed a voluntary petition for relief under Chapter 11 of Title 11, United States Code, 11 U.S.C. § 101, *et seq.* (the "Bankruptcy Code"). On June 26, 1997, the Committee was formed under the auspices of the Office of the United States Trustee for the Eastern District of New York.

As set forth herein, the complaint filed by the Hospital and the Committee demands the payment to the Debtor (and thereby, to the Debtor's creditors) of interest earned or proceeds derived from the Debtor's money held by Blue Cross pursuant to the terms of a poorly drafted New York State cited as NYCRR 91.4(i) (the "Withholding Regulation"). Pursuant to 10 NYCRR 91.4(a), the Superintendent of Insurance and the New York State Department of Health (the "DOH") were charged to create and oversee the New York State Excess Liability Pool ("NYSELP") (the DOH and NYSELP are collectively referred to hereinafter as the "State Agencies"), which was to consist of certain funds (the "Pool Funds"). These Pool Funds are derived from payments to the State Agencies by hospitals based on a portion of the hospital's in-patient rates together with an amount calculated in relation to the hospital's cost of excess insurance coverage (the "Malpractice Pools"). The Pool Funds would then be available to make payments back to hospitals as reimbursement for *inter alia*, bad debt and charity care pools, primary health care pools, and financially distressed hospital pools.

Pursuant to 10 NYCRR 91.4(i), if any hospital fails to timely submit payment to the Pool Funds, the State Agencies can direct the withholding of ten percent of the hospital's payments from certain third-party payors, such as Blue Cross, until such time that the required payments are received by the State from the hospital. Thus the Withholding Regulation empowers the State Agencies to require third party payors to hold funds actually due and owing to the hospital until the hospital pays its contributions to the State Agencies. There is no provision, however, in the Withholding Regulation for the turnover of the withheld funds to the State Agencies or to any party *other than to the hospital*. Rather,

the funds are to be held until such time that the hospital pays its arrears to the State Agencies at which time the funds are released to the hospital.

The Hospital, plagued by financial troubles, failed to pay the Pool Funds. Consequently, at the direction of the State Agencies, Blue Cross, among others, withheld (pre-petition and post-petition) up to ten percent of the funds owed to the Hospital for payment of claims submitted to Blue Cross for health related services performed by the Debtor. In total, approximately $5.5 million of the Debtor's money was withheld by various third-party payors prior to the Filing Date, approximately $4.5 million of which was withheld by Blue Cross over a period of seven years (the "Withholdings").

By order to show cause dated October 16, 1997, the Debtor moved for, *inter alia*, an order disallowing setoffs and/or recoupment claimed or taken by the State Agencies, directing the payment of the Withholdings to the Debtor and an accounting of all monies withheld. The order to show cause was resolved by a stipulation between the Plaintiffs and the State Agencies which provided, *inter alia*, for the State Agencies to direct Blue Cross to turn over the Withholdings and provide an accounting for same (the "Stipulation").

On or about January 19, 1998, Blue Cross provided the Debtor with an accounting of the Withholdings. The accounting was silent as to what interest, if any, had accrued on the $4.5 million it was holding for more than seven years. On or about January 23, 1998, Debtor's counsel received the Withholdings from Defendant in the approximate amount of $4.5 million.

According to a calculation of accrued interest earned, or interest that would have been earned on the Withholdings prepared by the accountants for the Committee, the "value" of $4.5 million over seven years, depending on the applicable interest rate (5% is the treasury rate, 8% is the statutory rate), is between $1.5 million and $2.3 million. The Debtor alleges that any interest earned or proceeds derived from the Withholdings in the custody of Blue Cross has been unjustly and inequitably retained by Blue Cross in violation of the provisions of the Bankruptcy Code.

By summons and complaint dated October 6, 1998 (the "Complaint"), the Debtor and the Committee commenced an adversary proceeding against Blue Cross (the "Adversary Proceeding") seeking the turnover of property of the estate, pursuant to Section 542 and 543 of the Bankruptcy Code, consisting of any interest earned by Blue Cross while it held the Debtor's money under the Withholding Regulation. The Complaint also asserted a cause of action for unjust enrichment, breach of fiduciary duty and negligence. On November 30, 1998, Blue Cross filed an answer to the Complaint (the "Answer"), wherein it denied virtually all of the material allegations thereof, raised various affirmative defenses thereto and demanded a jury trial.

On February 11, 1999, Blue Cross filed a Motion requesting that the Bankruptcy Court enter an order: (1) abstaining from hearing the Adversary Proceeding, pursuant to 28 U.S.C. § 1334(c)(1) or, in the alternative; (2) granting summary judgment in favor of Blue Cross with respect to each and every claim asserted against it in the Complaint (the "Summary Judgment Motion").

A hearing was held on the Summary Judgment Motion on March 17, 1999. Based on the premise that, absent a contractual or statutory provision, there is no entitlement to interest, Judge Holland granted summary judgment with respect to all counts of the Complaint in favor of Blue Cross. The determination embodied in the Bankruptcy Order was to be more fully set forth in an opinion to be issued in connection with the Summary Judgment Motion. Although an order memorializing same was entered on April 29, 1999, no such opinion has been issued and Judge Holland retired from the bench on September 15, 1999. The case was assigned to Chief Bankruptcy Judge Conrad B. Duberstein who respectfully declined to write an opinion.

By Notice of Appeal dated May 4, 1999, the Debtor and the Committee jointly filed an appeal to the United States District Court for the Eastern District of New York from the Bankruptcy Order granting summary judgment to Blue Cross and dismissing the Complaint. Based solely on the written submissions of the parties, without oral argument, on September 23, 2000, Judge Arthur D. Spatt, United States District Judge, issued an order (the "District Court Order") affirming the Bankruptcy Order and the oral decision of Judge Holland granting Blue Cross' Motion for Summary Judgment. The District Court based its decision on a legal finding that the Withholdings were not property of the estate. In so ruling, the District Court focused on malfeasance and blame, both of which are irrelevant to the Plaintiffs' causes of action. The Plaintiffs then appealed the District Court Order to the United States Court of Appeals for the Second Circuit.

In accordance with a decision dated January 15, 2002, the Court of Appeals affirmed the District Court order. However, the decision of the Court of Appeals was based on

a different and incompatible legal basis from that of the District Court. In its decision, the Second Circuit clearly held that the Withholdings were property of the estate in accordance with Section 541 of the Bankruptcy Code. On page 6 of the Order, the Court states, "As of the date Mid-Island filed its reorganization petition, its right to the withheld funds was contingent on satisfying its obligation to the excess liability pool." As was set forth in detail in the Appellants' Brief, property of the estate is broadly defined and includes property in which the debtor did not have a possessory interest at the time of the bankruptcy filing. This finding by the Court is supported by the fact that, pursuant to the Withholding Regulation, the Withholdings could not have been turned over to any party other than the Debtor. The Withholding Regulation provides that the Withholding be released to the Hospital upon payment of its obligations to the New York State Funds. There is no provision, even upon continued default, for the funds to be turned over to the State to satisfy the Hospital's obligation and, of course, no possibility that the Withholdings would at some point be turned over to Blue Cross. Consequently, Mid-Island had the superior right and title to the Withholdings over any other party and, as such, and consistent with the holding of the Court of Appeals, the Withholdings must be considered "property of the estate" as that term is used in the Bankruptcy Code.

After finding that the Withholdings were property of the estate, the Court of Appeals continues "finding that the estate had a contingent interest in the withheld funds does not end our inquiry; we must still determine whether Mid-Island's contingent interest gave it a right to profits from or interest on the withheld funds accruing during the period Empire held them." *See* Order at p. 7. Thereafter, the Court of Appeals

concludes that "no separate analysis is required for Section 541(a)(6) because it conveys no greater right than Mid-Island would have under state law" *Id.* The Court of Appeals, having determined that Mid-Island had no right to interest under state law, affirmed the District Court's Order.

Based on the belief that the Second Circuit Court erred by misinterpreting and failing to apply Section 541(a)(6) of the Bankruptcy Code which states that all profits and proceeds of property of the estate are, in fact, property of the estate, the Petitioners filed a Petition for Rehearing. In its petition, the Plaintiffs noted that The Second Circuit found that the Debtor did in fact have an interest in the Withholdings. As a result, the Withholdings were property of the Debtor's bankruptcy estate pursuant to Section 541 of the Bankruptcy Code. However, with respect to the issue of interest, proceeds or profits pursuant to Section 541(a)(6), the Second Circuit found that no separate analysis was required since Mid-Island did not have any right to interest under state law. The Petitioners argued that this conclusion misconstrued the mandates of the Bankruptcy Code and that an analysis of Section 541(a)(6) is exactly what is required. Even given the Circuit Court's finding that Blue Cross was not obligated to earn or pay interest or to invest the Withholdings on Mid-Island's behalf based on any of the various state law causes of action asserted by Mid-Island, the Circuit Court still had an independent duty to apply the provisions of the Bankruptcy Code. Such an analysis would mandate that interest, profits or proceeds *actually earned* on the Withholdings is, without dispute, property of the estate. This is so without regard to any duty to earn interest. Based thereon, it is apparent that a granting of summary judgment to Blue Cross, before any discovery was conducted to determine whether interest, profit or proceeds were *actually* earned on the Withholdings, was premature and should be reversed.

On March 7, 2002, the United States Court of Appeals for the Second Circuit issued an order denying the Petition for Rehearing.

REASONS FOR GRANTING THE WRIT

The Writ should be granted for two reasons. First, the inconsistency between the District Court and the Court of Appeals decisions warrants review by this Court. Second, the Circuit Court grossly misinterpreted the provisions of Section 541(a)(6) of the Bankruptcy Code which provisions are clear that any interest earned on the Withholdings is also property of the estate. Such a precedent at the Circuit level which vitiates the clear provisions of Section 541(a)(6) of the Bankruptcy Code should not stand as the law of the Second Circuit. Based on the above, it was inappropriate to grant summary judgment before a determination was made as to whether interest was actually earned on the Withholdings.

I. THE CIRCUIT COURT ERRED IN NOT APPLYING SECTION 541(a)(6) OF THE BANKRUPTCY CODE IN FINDING THAT INTEREST, PROFIT AND PROCEEDS EARNED ON PROPERTY OF THE ESTATE ARE NOT PROPERTY OF THE ESTATE

In actuality, the Circuit Court's Order reversed that portion of the District Court Order which held that the Withholdings were not property of the estate. Under the provisions of the Bankruptcy Code, it is without question that the Withholdings were property of the Debtor's estate and the Circuit Court appears to agree with this proposition. Section 541(a)(1) of the Bankruptcy Code provides that property of the estate includes "all legal or equitable interests

of the debtor in property as of the commencement of the case." The scope of Section 541(a) is broad. It includes all kinds of property, including tangible or intangible property, and causes of action. *See* H.R. Rep. No. 95-595, p. 367 (1977); S. Rep. No. 95-989, p. 82 (1982).

Blue Cross withheld the Withholdings pursuant to the terms of the Withholding Regulations. At the time of Mid-Island's bankruptcy filing, the Withholdings were simply in the custody of Blue Cross. In fact, pursuant to the express terms of the Withholding Regulation, the ownership of the Withholdings was not transferred to either Blue Cross or the State. The Withholding Regulation clearly does not provide for title to the Withholdings to vest, at any time, in any entity other than the Hospital, not even New York State. 10 NYCRR § 91.4(i), does not provide a mechanism for payment of the Withholdings to any entity at any time other than to the Hospital upon receipt by the State of the "required checks." Pursuant to the Stipulation entered into by the Debtor and the New York State Department of Health ("DOH") during the bankruptcy case, Blue Cross, at the direction of DOH, finally paid the Withholdings to the Debtor in the approximate amount of $4.5 million. The DOH had no authority to require the turnover of the Withholdings to the State Agencies in satisfaction of the outstanding amounts due from the Hospital to the Pools. The DOH merely had the authority to prevent the turnover of the Withholdings as a disincentive to the Debtor until the payments due the State Agencies were paid. Thus, there was absolutely no other entity which could have claimed ownership to the Withholdings other than the Debtor and accordingly, the Withholdings were clearly property of the estate.

At the heart of the Plaintiffs' Petition for a Writ of Certiorari is the Petitioners' dismay with regard to this Court of Appeal's decision to decline to apply Section 541(a)(6) of the Bankruptcy Code. It is the Petitioners' view, based on the plain wording of the statute, that once there is a determination that something is property of the estate, any interest, profits, or proceeds earned on such property, with certain limited exceptions, is automatically also property of the estate pursuant to Section 541(a)(6) of the Bankruptcy Code. Section 541(a)(6) provides that property of the estate includes "proceeds, product, offspring, rent and profits of or from property of the estate. . . ." The intent of this provision "is to be broadly construed even beyond the definition of proceeds in the Uniform Commercial Code." *In re Granite Lumber Company*, 63 B.R. 466, 472 (Bankr. D. Mont. 1986). Thus, interest or profits, if any, earned on the Withholdings clearly comes within the purview of section 541(a)(6). *Cf. In re Bentley*, 916 F.2d 431, 432 (8th Cir. 1990) (income generated from sale of corn as well as income arising from interest earned on the proceeds constituted property of the estate under section 541(a)(6)); *In re Rundlett*, 136 B.R. 376, 380 (S.D.N.Y. 1992) (income from invested insurance proceeds, in addition to proceeds themselves, constitutes property of the estate under section 541(a)(6)); *In re #1 Con-Struct Corp.*, 88 B.R. 452, 453 (Bankr. S.D. Fla. 1988) ("The policy proceeds and interest thereon, being proceeds of Property of the Estate, became Property of the Estate pursuant to § 541(a)(6)") (emphasis added). The cases cited herein hold that interest, profit and proceeds are property of the estate without any independent state law which would require the payment of interest or proceeds. In fact, it appears that in each case cited there was no independent state law which required payment of interest on any of the claims at issue. Rather the courts relied solely on an application of Section 541(a)(6) of the Bankruptcy Code.

The Petitioners submit that the Circuit Court's failure to analyze and apply Section 541(a)(6) was an unfortunate omission which warrants the granting of a Petition for a Writ of Certiorari. Regardless of any entitlements to interest under state law, the Bankruptcy Code provides its own separate and distinct mechanism for allocating the ownership of any interest, profits or proceeds actually earned on property of the estate. This provision cannot simply be ignored. Accordingly, this Court is obligated by the provisions of the Bankruptcy Code to make the determination that if any interest or profits were made by Blue Cross on the Withholdings, such interest or profit is property of the estate and must be turned over to the Debtor for the benefit of its creditors.

This conclusion, that interest or proceeds of property of the estate becomes estate property, is regardless of any obligation which may or may not exist under applicable state law to pay or earn interest (as previously stated in detail and as set forth in cases such as *In re Granite Lumber Company*, 63 B.R. 466, 472 (Bankr. D. Mont. 1986); *In re Bentley*, 916 F.2d 431, 432 (8th Cir. 1990); *In re Rundlett*, 136 B.R. 376, 380 (S.D.N.Y. 1992) and *In re #1 Con-Struct Corp.*, 88 B.R. 452, 453 (Bankr. S.D. Fla. 1988)). Thus, the analysis of the Second Circuit Court as to whether there was an obligation under state law for Blue Cross to pay interest on the Withholdings was misguided. Rather, the issue under 541(a)(6) is whether the Withholdings *did, in fact, generate interest or proceeds*; if so, those proceeds are property of the estate under 541(a)(6). Whether the Withholdings, while in the hands of Blue Cross, did, in fact, generate interest or proceeds is a question of fact to be determined at trial thereby precluding summary judgment (discussed in detail below). However, if it is found that there was not interest earned on,

or proceeds derived by Blue Cross owing to the Withholding, then, consistent with the Circuit Court's decision, 541(a)(6), does not impose a duty above any found in state law for Blue Cross to remit a return on the Withholdings. We believe that the issue would be clearer if Blue Cross had kept the Withholdings in a separate interest bearing account. Upon the eventual turnover of the Withholdings, the interest earned on this escrow account would also have to be turned over consistent with § 541(a)(6). The fact that the funds were not so segregated should not alter the analysis. If the Withholdings did, in fact, generate interest or proceeds, they should be turned over. If it is shown that the Withholdings did not, in fact, generate interest or proceeds, § 541(a)(6) would impose no liability on Blue Cross.

II. UNDETERMINED FACTUAL ISSUES EXIST WHICH PRECLUDE THE GRANTING OF SUMMARY JUDGMENT

It must be reiterated that with respect to the non-state law portion of the complaint, the Petitioners were not requesting the absolute payment of interest or profits on the Withholdings. Rather, the Petitioners are seeking a factual determination of whether such interest or profits were actually earned and if so, the payment thereof. Moreover, the Petitioners have at no time argued that the Withholding Regulation itself in any way obligated Blue Cross to invest the funds for Mid-Island's benefit and thus this need not be a matter for the Court to consider. However, given the nature of the Petitioners' request under Section 541(a)(6) it is necessary to make a determination of the factual circumstances. Accordingly, it was inappropriate for summary judgment to be granted before such a determination could be made. Summary judgment is a drastic remedy that should be granted only where

no triable issue of fact is present. *See Hamilton v. Smith*, 773 F.2d 461 (2d Cir. 1985); *Katz v. Goodyear Tire & Rubber Co.*, 737 F.2d 238 (2d Cir. 1984). On a motion for summary judgment, the movant bears the initial burden of showing that there are no genuine issues of material fact. *Anderson v. Liberty Lobby*, 477 U.S. 242, 256, 106 S. Ct. 2505, 2514, 91 L. Ed. 2d 202 (1986). *Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 106 S. Ct. 1348, 1355-56, 89 L. Ed. 2d 538 (1986); *Celotex Corp. v. Catreti*, 477 U.S. 317, 323, 106 S. Ct. 2548, 2552, 91 L. Ed. 2d 265 (1986); *Anaren Microwave, Inc. v. Loral Corp.*, 855 F. Supp. 634, 637 (S.D.N.Y. 1994). It is well settled that on a motion for summary judgment, the court is constrained to view the evidence in a light most favorable to the nonmoving party. *See United States v. Diebold, Inc.*, 369 U.S. 654, 655, 82 S. Ct. 993, 994, L. Ed. 2d 176 (1962); *Cinema North Corp. v. Plaza at Latham Assoc.*, 867 F.2d 135 (2d Cir. 1989). Furthermore, summary judgment should not be granted unless the nonmoving party has been afforded sufficient time for discovery. *See, e.g., Quinn v. Syracuse Model Neighborhood Corp.*, 613 F.2d 438, 445 (2d Cir. 1980); *Mauney v. Imperial Delivery Services, Inc.*, 865 F. Supp. 142, 148 (S.D.N.Y. 1994).

Blue Cross sought summary judgment based on its assertion that there were no genuine issues of material fact to be determined. Blue Cross has nonetheless failed to meet its burden in this regard and consequently, summary judgment is inappropriate. In reality, there are unanswered questions which to date Blue Cross has never addressed, let alone answered.

Specifically, it remains unknown as to whether the Withholdings, which were unquestionably property of the Debtor's estate under Bankruptcy Code § 541, generated proceeds or profits or interest while being held by Blue Cross and if so, how much. Blue Cross has at no time actually denied

the foregoing. Indeed, it is somewhat inconceivable to comprehend that a sophisticated business like Blue Cross would have kept $4.5 million in the bank and would not have earned interest on such a substantial sum. Moreover, Blue Cross has failed to submit any evidence demonstrating that no interest was earned on the withheld money. Instead, Blue Cross submitted the affidavits of H. Charles Wanko and Mark H. Van Guysling, which merely assert that the DOH did not direct Blue Cross to segregate the Withholdings in any way. These affidavits are irrelevant and lend no support to Blue Cross' argument regarding the Debtor's entitlement to any interest actually earned. If the Withholdings did generate interest, proceeds or profits, those funds are clearly property of the Debtor's estate. If Blue Cross can show that it held the Withholdings in a non-interest bearing account, then there would be no liability on the part of Blue Cross with respect to interest or proceeds.

Blue Cross concedes that the Withholdings were not segregated, but instead remained in one of Blue Cross' operating accounts from which checks to health care providers were drawn. Palmateer Affidavit at paras. 6, 7 and 9; H. Charles Wanko Affidavit at paras. 6, 7 and 8. An issue of fact exists as to whether these operating accounts were interest bearing accounts. Another material issue is whether the Withholdings were actually used by Blue Cross, which would then have had the benefit of $4.5 million with no financing charges it would otherwise had to have paid for the use of this money. It is ultimately possible that this value may be determined to be a profit or proceeds attributable to the Withholdings.

The issues of fact described herein are not specifically addressed, let alone resolved, by any of the affidavits submitted by Blue Cross in connection with the Motion. The Petitioners clearly made a prima facie case demonstrating

that material questions of fact exist sufficient to preclude summary judgment. Moreover, given that the case was at an early stage and no discovery was conducted, if the Court below somehow found that the facts in controversy were not sufficiently established, the Court should have, at the very least, granted Plaintiffs discovery to allow them to more fully establish the underlying facts as to interest or profits on the Withholdings. It was, therefore, wholly inappropriate and certainly premature for the lower Court to grant summary judgment before discovery could be completed. As a result, the Circuit Court erred in affirming the District Court Order which affirmed the Bankruptcy Order granting summary judgment and, accordingly, the Order must be reversed.

CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DECIDED JANUARY 15, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2000

(Argued: June 1, 2001 Decided: 1/15/02)

Docket No. 00-5076

In re MID-ISLAND HOSPITAL, INC.,

Debtor.

MID-ISLAND HOSPITAL, INC. and
OFFICIAL COMMITTEE OF UNSECURED
CREDITORS OF MID-ISLAND HOSPITAL, INC.,

Plaintiffs-Appellants,

-v.-

EMPIRE BLUE CROSS AND BLUE SHIELD,

Defendant-Appellee.

Before: WALKER, *Chief Judge*, CALABRESI and POOLER, *Circuit Judges.*

Appeal from a grant of summary judgment. AFFIRMED. Chief Judge Walker concurs in a separate opinion.

Appendix A

POOLER, *Circuit Judge:*

This appeal requires us once more to address the meaning of "property of the estate" as it is used in the Bankruptcy Code. Plaintiffs Mid-Island Hospital, Inc. (the "Hospital") and Official Committee of Unsecured Creditors of Mid-Island Hospital, Inc. (the "Committee") (collectively, "Mid-Island") claim that because funds that state regulation required Empire Blue Cross and Blue Shield ("Empire") to withhold from payments otherwise due to the Hospital are property of the Hospital's estate in bankruptcy, Empire is obligated to pay interest on the withheld funds to the estate. We agree that the Hospital had a limited, contingent interest in the withheld funds when it filed its petition for reorganization. However, we find that Empire had no obligation to pay Mid-Island interest or invest the funds for Mid-Island's benefit and therefore affirm the district court's judgment dismissing Mid-Island's adversary complaint.

BACKGROUND

New York law requires hospitals to make payments into various pools that the State uses, among other things, to fund excess liability insurance for physicians and dentists who provide emergency care. *See, e.g.,* 1986 N.Y. Laws ch. 266 § 18(1), 4(b), (5).[1]

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1. Although the 1986 Act was time limited, subsequent legislation carried forward its relevant provisions. *See* N.Y. Ins. L. § 3436 (McKinney 2001) historical and statutory notes.

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State regulations require insurers to withhold 10% of the moneys due to a hospital that becomes delinquent on its obligation to the pools. The excess liability regulation provides:

> If any hospital shall fail to timely submit checks [to the excess liability pool] in accordance with this section, the hospital shall have 30 days from date of receipt of notification to provide the required checks. Failure to submit the checks within this 30 day time period shall result in the withholding of 10 percent of the hospital's payments from all major third-party payors regulated pursuant to Subpart 86-1 of this Title until such time as the required checks are received by the pool administrator.

10 N.Y. Comp. Codes R. & Regs. § 91.4(i).

The Hospital eventually defaulted on its obligations to the state pools, and, in 1989, the State directed Empire to withhold 10% of all payments due and owing to the Hospital. As of January 1998, Empire had withheld $4.5 million in payments that it otherwise would have made to the Hospital.

On June 20, 1997, the Hospital filed a voluntary Chapter 11 petition. Approximately six weeks later the Hospital, the Committee, the Trustee, and Empire entered into a stipulation that, among other things, provided that Empire would continue to withhold 10% of the moneys otherwise due to the Hospital unless and until the Hospital obtained an order from the bankruptcy court establishing that Empire could no longer withhold those funds. In October 1997, at the behest of the state, Empire released approximately $135,000 to the Hospital to enable it to meet payroll obligations.

That same month the Hospital sought an order directing that Empire turn over all the withheld funds together with an accounting for these funds to the Hospital's attorneys. On November 24, 1997, the Hospital, Committee, Trustee, and State stipulated that the State would direct Empire to pay over $4.5 million to the Hospital's attorneys to be held in an interest-bearing escrow account or invested in a manner acceptable to the Trustee. In January 1998, shortly after bankruptcy court approved the stipulation, the Hospital's attorneys demanded that Empire promptly pay them "approximate[ly] $4,500,000.00 [and make] a date of deposit accounting of all withheld funds." On January 23, 1998, Empire wire transferred $4,379,597.52 to the Hospital to be held in escrow.[2]

In October 1998, Mid-Island commenced this adversary proceeding to recover interest (or other profits) arising from the withheld funds. Mid-Island claimed that the interest was either property of the debtor or profits from property of the debtor subject to turnover pursuant to 11 U.S.C. § 543. In addition, Mid-Island asserted a right to interest on state law grounds including unjust enrichment, breach of fiduciary duty, and negligence. In November, the Committee, the Hospital, and the State agreed that $2,222,000 of the withholdings would be paid to the State in satisfaction of all of its pre-petition claims. Mid-Island calculates the value of the interest owing to the estate at between $1.5 million and $2.3 million.

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2. The slightly lower amount is the result of a prior overpayment Empire was allowed to deduct from the withheld funds.

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In February 1999, Empire made a motion requesting that bankruptcy court either abstain from hearing Mid-Island's claims or grant Empire summary judgment on those claims. Bankruptcy Judge Holland granted Empire's motion for summary judgment in an order signed April 27, 1999. In an oral decision, Judge Holland explained that

> I do not see that the debtor has made out a prima facie entitlement to interest without an existing obligation to pay and a demand that was properly made that hadn't been complied with. Or in the alternative, which I don't think is at issue here, either a statute or a contract that requires the payment of interest.

In response to a question from counsel about unjust enrichment, the court said, "It's enrichment, but it's not unjust."

On appeal, the district court (Spatt, *J.*) affirmed. *In re Mid-Island Hosp.*, 254 B.R. 71 (E.D.N.Y.2000). Judge Spatt found that the withheld funds were not property of the estate in bankruptcy because the Hospital was not entitled to them as of the date it filed its petition. *Id.* at 75. Building on this premise, he then concluded that any interest or profits from the withheld funds did not belong to the estate. *Id.* at 76. The district court also found that Mid-Island could not sustain its claims for unjust enrichment, breach of fiduciary duty, and negligence. *Id.* at 76-77.

This appeal followed.

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DISCUSSION

Mid-Island contends that it is entitled to interest (or lost profits) on the withheld funds either because those funds were property of the estate or because Empire had an obligation under a variety of state law theories to invest them for the benefit of Mid-Island.

I. Mid-Island's Interest in the Withheld Funds

We review *de novo* the district court's determination that a given item is or is not property of the estate. *See In re Renshaw,* 222 F.3d 82, 86 (2d Cir. 2000). Property of the estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). This definition is broad and includes even strictly contingent interests. *Brown v. Dellinger (In re Brown),* 734 F.2d 119, 123 (2d Cir. 1984). The existence of a property interest is determined by state law. *Butner v. United States,* 440 U.S. 48, 55 (1979).

Mid-Island's right to the withheld funds flowed from Empire's agreement with its subscribers to pay providers for services, but New York law modified Mid-Island's rights under those contracts. Although Mid-Island ordinarily had a right to payment from Empire after it provided services to an Empire insured, Section 91.4(i) defeated this contractual right if Mid-Island failed to make its required payments to the State. This unusual blend of contractual and regulatory rights and obligations frames the debate between Mid-Island and Empire.[3]

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3. The concurrence urges that it is unnecessary to decide whether Mid-Island had a property interest in the withheld funds. We do so

(Cont'd)

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As of the date Mid-Island filed its reorganization petition, its right to the withheld funds was contingent on satisfying its obligation to the excess liability pool. Not having made the required payments, Mid-Island had no current possessory interest in the funds when it filed its reorganization petition. N.Y. Comp. Codes R. & Reg., tit. 10 § 91.4(i); *see also In re Nemko, Inc.*, 143 B.R. 980, 987 (Bankr. E.D.N.Y. 1992) ("The filing of a petition in bankruptcy does not confer upon the Debtor a right to be paid sooner than it would under the terms of the Contract."). However, the Hospital's "speculative" and "intangible" interest in the funds, which was contingent on the satisfaction of its obligations to the State, was property of the estate. *See In re Prudential Lines, Inc.*, 928 F.2d 565, 572 (2d Cir. 1991) (holding that contingent interest in carrying forward net operating loss to offset against future income is property of the estate); *In re Neuton*, 922 F.2d 1379, 1382-83 (9th Cir. 1990) (holding that debtor's interest in trust income, which was contingent on surviving primary beneficiary, was estate property).[4]

(Cont'd)
for two reasons. First, the district court premised its decision on its finding that Mid-Island had no property interest in the withheld funds. Second, we find it difficult to determine whether Mid-Island is entitled to interest without first determining the scope, if any, of its property interest.

4. The cases on which Empire relies, *In re Guiding Light Corp.*, 217 B.R. 493 (Bankr. E.D. La. 1998); *In re Great South Beach Constr.*, 145 B.R. 372 (E.D.N.Y. 1992), and *In re Pelham Fence Co.*, 65 B.R. 924 (Bankr. S.D.N.Y. 1986), do not require a contrary result. The *Great South Beach* and *Pelham* courts considered, respectively, the current and a prior version of New York Labor Law § 220-b, which then

(Cont'd)

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Finding that the estate had a contingent interest in the withheld funds does not end our inquiry; we must still determine whether Mid-Island's contingent interest gave it a right to profits from or interest on the withheld funds accruing during the period Empire held them. Mid-Island claims a right to profits or interest from the withheld funds both as "proceeds" or "profits" of property of the estate pursuant to 11 U.S.C. § 541(a)(6) and on a variety of state law theories. However, no separate analysis is required for Section 541(a)(6) because it conveys no greater right than Mid-Island would have under state law. Thus, we look to state law to determine what, if any obligation, Empire had to invest the funds for Mid-Island's benefit or to pay interest on them.

(Cont'd)
and now authorizes the withholding of funds from payments that otherwise would be due to companies who contract with public entities and are alleged not to have paid their workers in accordance with law. Both courts found that the bankruptcy estate of a debtor contractor did not have a property interest in these funds. In *Pelham*, this result derived from the fact that "the prepetition debtor had no equity in the funds held by" the state fiscal officer because the liens on the project exceeded the amount withheld and the Department of Labor had issued a final order determining the amount due to laborers on the project. 65 B.R. at 927. In *Great South Beach*, the court reached the same result although the Commissioner had not issued a final order because the amended statute required that withheld funds be held "*for the sole and exclusive benefit of workers employed on said public improvement.*" 145 B.R. at 374 (quoting N.Y. Labor L. § 220-b(2)(b) and adding emphasis). *Great South Beach* and *Pelham* cannot be extended to cover the funds held by Empire because at the time of Mid-Island's filing there had been no final determination of the amounts owed to the State and there is no language in Section 91.4(i) similar to the language in Section 220-b(2)(b). *Guiding Light* involved allegations of fraud, which are not present here. 217 B.R. at 495.

II. New York Law

Pursuant to New York law, an obligation to pay interest is not presumed. *See New York State Thruway Auth. v. Hurd,* 25 N.Y.2d 150, 158 (1969). In order for one party to owe another interest there must be an express or implied contract, a statutory obligation, or a default on an acknowledged obligation. *Id.* at 157-58. Although the commercial context of a transaction may "supply the necessary implication of interest," *id.* at 158, the facts in this case support no such implication. First, the regulation does not provide either that the Hospital must pay interest to the State or that Empire must pay interest to the Hospital. Second, an Empire officer swore that Empire had not paid interest to hospitals in the past when the State directed it to release withheld funds. Third, during the entire time Empire held the funds, the Hospital never demanded that Empire segregate them or place them in an interest-bearing account. Finally, no Hospital officer or employee swore that he believed there was an implicit agreement on Empire's part to pay interest. The summary judgment record supplies no basis from which a finder of fact reasonably could infer that both parties implicitly agreed to the payment of interest on the withheld funds. The withholding regulation does not require the payment of interest. There was no default on Empire's part. Thus, Empire does not owe interest on any contractual theory.

A. Unjust Enrichment

Mid-Island argues that, even absent a contractual obligation to pay interest, it is entitled to recover because Empire was unjustly enriched by its seven-year retention of the Hospital's

money. "To prevail on a claim for unjust enrichment in New York, a plaintiff must establish (1) that the defendant benefitted; (2) at the plaintiff's expense; and (3) that equity and good conscience require restitution." *Kaye v. Grossman,* 202 F.3d 611, 616 (2d Cir. 2000) (internal quotation marks omitted). Empire certainly benefitted from the retention of the Hospital's funds; if nothing else, Empire could use this money in lieu of its own funds. And, although Empire argues that its benefit was not at the Hospital's expense, there is some basis in the record for Mid-Island's claim that more funds were withheld than necessary to pay the Hospital's obligation to the State, creating an issue of fact on harm to the Hospital. However, Mid-Island's claim fails on the third prong; it is not against equity and good conscience to retain funds pursuant to a statutory or regulatory mandate. *See Marcus v. AT&T Corp.,* 138 F.3d 46, 64 (2d Cir. 1998).

B. Fiduciary Duty

Mid-Island contends that Empire had a fiduciary responsibility with respect to the withheld funds that required the insurance company to invest the funds or deposit them in an interest bearing account for Mid-Island's benefit. A debtor-creditor relationship is not by itself a fiduciary relationship although the addition of "a relationship of confidence, trust, or superior knowledge or control" may indicate that such a relationship exists. *Pan Am. Corp. v. Delta Air Lines, Inc.,* 175 B.R. 438, 511 (S.D.N.Y. 1994) (internal quotation marks and citation omitted). "[W]hen parties deal at arms length in a commercial transaction, no relation of confidence or trust sufficient to find the existence of a fiduciary relationship will arise absent extraordinary

circumstances." *Id.* (internal quotation marks omitted). Here, there is no allegation of anything other than an ordinary commercial relationship. In addition, although Empire had control of funds in which the Hospital had an equitable interest, Empire's control stemmed directly from a regulation which did not provide for payment of interest.

Relying on *National Union Fire Insurance Company v. Proskauer Rose Goetz & Mendelsohn,* 165 Misc.2d 539 (Sup. New York County 1994), Mid-Island also argues that the insurance company had a duty stemming from its status as a *de facto* escrow agent. An escrow agreement requires "(a) an agreement as to the subject matter and delivery of the same; (b) a third-party depositary; (c) delivery of the subject matter to a third party conditioned upon the performance of some act or the happening of the event; and (d) relinquishment by the promisor." *Id.* at 544-45. Empire's retention of the withheld funds did not involve delivery by any of the other parties of funds to Empire. Nor did either the State or the Hospital relinquish anything. Thus, Mid-Island cannot proceed on the theory that Empire acted as its escrow agent.

C. Negligence

Mid-Island finally contends that Empire dealt with the Hospital's money in a negligent fashion. The Hospital and Empire had a relationship that was defined by contract as modified by the withholding regulation. Therefore, Mid-Island cannot sustain a claim against Empire based on negligence unless public policy imposed an additional duty on Empire beyond those imposed by the contract and regulation.

See Sommer v. Fed. Signal Corp., 79 N.Y.2d 540, 551-52 (1992). Because Mid-Island identifies no such policy, its negligence claim fails.

CONCLUSION

For the reasons discussed, we affirm the judgment of the district court in its entirety.

JOHN M. WALKER, JR., *Chief Judge, concurring:*

I concur with the majority's disposition of this case because I do not believe that the interest on the withheld funds ever was property of the bankruptcy estate. However, my decision in this case rests solely on the majority's analysis of the Hospital's rights to the interest in Part II of the opinion's discussion section. The state law issue of whether the withheld funds themselves are property of the estate, discussed in Part I, need not have been reached in this case because the State chose to settle with Mid-Island and Empire returned the funds.

The majority's conclusion that the Hospital's speculative and intangible interest in the withheld funds, which was contingent on the satisfaction of its obligations to the State, was property of the estate is therefore dicta. The precedents on the issue of whether the state withholding regulation modifies a defaulting hospital's equitable claim in the withheld funds under New York law are not self-evident. Until the New York courts clarify this issue, or until we are squarely confronted with facts that require us to decide it, I see no reason why we should render what amounts to an advisory opinion on the subject.

APPENDIX B — MEMORANDUM OF DECISION AND ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK DATED SEPTEMBER 23, 2000

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

MEMORANDUM OF DECISION AND ORDER

99-CV-3600

In re

MID-ISLAND HOSPITAL,

Debtor.

Spatt, District Judge:

In this appeal from a decision of United States Bankruptcy Judge Marvin A. Holland, Debtor-Appellant Mid-Island Hospital and Appellant Official Committee Unsecured Creditors of Mid-Island Hospital (collectively, "Mid-Island") contend that Judge Holland erroneously granted summary judgment to Appellee Empire Blue Cross and Blue Shield ("Empire") on Mid-Island's claim for interest allegedly owed to it by Empire.

Regulations of the New York State Department of Health require hospitals such as Mid-Island to make monthly payments to the State, pursuant to an established formula, which the State then uses to reimburse eligible hospitals for various expenses. 10 NYCRR § 91.4. According to the

regulation, "Failure to submit [payment checks] shall result in the withholding of 10 percent of the hospital's payments from all major third-party [insurance] payors." 10 NYCRR § 91.4(*i*).

It is undisputed that by late 1989, Mid-Island was deficient in its payments to the State under Section 91.4, and, in December 1989, the State directed Empire to begin withholding 10% of its payments on claims made by Mid-Island. From December 1989 through January 1998, at the State's direction, Empire withheld approximately $4.5 million in payments to Mid-Island.

In the meantime, on June 20, 1997, Mid-Island filed a voluntary Chapter 11 petition. On December 18, 1997, Judge Holland "so ordered" a stipulation between Mid-Island and the State, curing Mid-Island's deficiencies and directing Empire to turn over the withheld funds. On January 23, 1998, Empire transferred the withheld funds to Mid-Island. From these funds, pursuant to a second stipulation with the State, Mid-Island paid roughly $2.2 million to the State in satisfaction of its past-due obligations under Section 91.4.

On October 6, 1998, Mid-Island commenced an adversary proceeding against Empire, seeking an award of interest earned by Empire on the withheld funds over the eight-year period it held them. Depending on the interest rate used, Mid-Island estimated this amount to be anywhere from $1.5 to $2 million. Mid-Island's complaint contained causes of action for turnover under 11 U.S.C. § 542 and § 543; unjust enrichment; breach of fiduciary duty; and negligence, all relating to the claim for interest on the withheld funds. On February 11, 1999, Empire

filed a motion for summary judgment, arguing that, as a matter of law, it was not required to pay interest on the withheld funds.

At a hearing on March 17, 1999, Judge Holland orally granted Empire's motion, stating that "I don't know of any way to have an obligation or to create an obligation to pay interest other than by statute, contract, or establishing a present entitlement to money plus a demand, a lawful proper demand, and an improper refusal to comply with the lawful demand. Those are the only three instances that I'm aware of that create an obligation to pay interest." Judge Holland stated that a written decision embodying his oral ruling would follow, but he retired before ever issuing a written opinion on the case. Upon a stipulated application by all parties, this Court agreed to consider this appeal from Judge Holland's oral ruling.

DISCUSSION

A district court hearing an appeal from a Bankruptcy Court reviews that Court's findings of fact under the "clearly erroneous" standard, *see* Fed. R. Bankr. 8013, while its conclusions of law are reviewed under the *de novo* standard. *See In re Arochem Corp.*, 176 F.3d 610, 620 (2d Cir. 1999); *In re Bennett Funding Group, Inc.*, 146 F.3d 136, 138 (2d Cir. 1998); *See also In re Porges*, 44 F.3d 159, 162 (2d Cir. 1995).

A. As to Mid-Island's claim for turnover under 11 U.S.C. § 542 and § 543

Mid-Island contends that, under the provisions of 11 U.S.C. § 543(b)(1), the interest on the withheld funds constitutes "proceeds, products, offspring, rents or profits"

of its property — the withheld funds — held by Empire, and thus, that interest is subject to a proceeding for turnover under 11 U.S.C. § 542(a). A turnover proceeding may be brought by the debtor or trustee to recover property of the estate that is being held by another. 11 U.S.C. § 542; *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 206 (1983); *In re Realty Southwest Assocs.*, 140 B.R. 360, 365 n. 2 (Bankr. S.D.N.Y. 1992). Whether a particular item is property of the estate in bankruptcy is governed by principles of state law, *In re McLean Trucking Co.*, 74 B.R. 820, 826-27 (Bankr. W.D.N.C. 1987), and the assessment is made as of the date of the filing of the bankruptcy petition. 11 U.S.C. § 541; *In re Scarpino*, 113 F.3d 338, 340 (2d Cir. 1997).

In *In re Pelham Fence Co.*, 65 B.R. 924, 927-28 (Bankr. S.D.N.Y. 1986), the court dealt with a somewhat similar situation. There, a construction contractor was concededly owed money for work on a project, but pursuant to Labor Law § 220(b)(2), the State directed the payor to withhold certain funds from its payment on the contract pending an investigation into whether the contractor failed to comply with wage-payment laws. The Bankruptcy Court found that these withheld funds were not "property of the estate" of the contractor under 11 U.S.C. § 541. The court in *Pelham* observed that "[a]ny such funds which are subject to a section 220-b(2) withholding order . . . cannot be regarded as property of the employer or funds which the employer was entitled to use or possess," and thus, not property of the estate in bankruptcy. *Id.* at 928.

Similarly, in *In re Guiding Light Corp.*, 217 B.R. 493, 498 (Bankr. E.D. La. 1998), the court found that the

bankruptcy estate could not claim reimbursement funds for services provided which were withheld by the Louisiana Department of Health and Hospitals pending a fraud review as "property." Relying on the Second Circuit's opinion in *Tekkno Laboratories, Inc. v. Perales,* 933 F.2d 1093 (2d Cir. 1991), which held that a hospital had no property interest in withheld Medicaid funds, the court in *Guiding Light* found that "a medical care provider does not have a property interest [for bankruptcy purposes] in Medicaid payments for claims pending investigation for fraud or willful misrepresentation." 217 B.R. at 498.

By the reasoning in cases such as *Pelham Fence* and *Guiding Light,* the Court is persuaded that the monies withheld from Mid-Island under Section 91.4(*i*) do not constitute "property of the estate." By the terms of the regulation, until Mid-Island satisfied its obligations to the State, it was not entitled to the use or possession of the withheld funds in the custody of Empire. Mid-Island argues that Section 91.4(*i*) is different from statutes or regulations like the one in *Pelham,* which allowed the State to pay claimants directly from the withheld funds, or *Guiding Light,* which presumably allowed the state to disclaim the payments entirely if fraud was found, because Section 91.4(*i*) makes no provision for the monies in Empire's possession to be forfeited to the State or paid to any entity other than the hospital. The Court disagrees.

Although the language of Section 91.4(*i*) does not expressly provide that the State may seek to levy against withheld funds to satisfy a delinquent hospital's payment obligations, clearly the purpose of setting aside the funds is

to provide for just such a contingency. Mid-Island's argument that the State could not tap withheld funds to offset the balance owed by a steadfastly recalcitrant hospital is simply illogical. Indeed, under Mid-Island's reading of the regulation, had the State been unable or unwilling to reach a settlement with Mid-Island in satisfaction of the delinquent payments, the withheld funds would have remained forever on the books of Empire, unreachable by the State, Empire, or anyone else, yet unavailable to Mid-Island as a result of the ongoing withholding order. Obviously, such a construction is untenable and does not effectively provide a method to ensure compliance with the pool contribution requirements. With reasonable certainty, had Mid-Island refused to pay its pool contributions, the State would have commenced an action to seize the withheld funds in Empire's possession and use them to offset Mid-Island's underpayments.

Therefore, the Court finds that, like in *Pelham* and *Guiding Light,* the funds withheld pursuant to Section 91.4(*i*) should not considered part of Mid-Island's estate in bankruptcy. *See also In re Great South Beach Const.,* 145 B.R. 372 (E.D.N.Y. 1992).

In this regard, Mid-Island's reliance on *In re Nemko, Inc.,* 143 B.R. 980, 985-86 (Bankr. E.D.N.Y. 1992), is misplaced. In *Nemko,* the court found that "an admitted liability owed to a debtor under a contract is property of the estate, even though the debtor's subcontractors may have claims against parties to the contract." *Id.* However, as discussed above, the Court finds that the withheld funds are less "an admitted liability owed to a debtor under a contract," and more akin to a trust or escrow account set aside for the State's benefit should a hospital prove to be chronically delinquent.

Appendix B

Because the Court determines that the withheld funds were not "property of the estate" at the time Mid-Island filed its petition for bankruptcy, Mid-Island is not entitled to claim the interest on those funds as "proceeds" from its property under Section 543. Accordingly, the Court finds that Mid-Island cannot maintain a turnover proceeding to reach property that does not belong to it, and Judge Holland did not err in granting summary judgment to Empire on the turnover claims.

B. As to the state law causes of action

Mid-Island also pleaded several claims under state law to recover the interest on the withheld funds, including claims for unjust enrichment, breach of fiduciary duty, and negligence.

In order to state a claim for unjust enrichment in New York State, a plaintiff must show that (i) the defendant was enriched; (ii) at the plaintiff's expense; and (iii) that it is against equity and good conscience to permit the defendant to retain that sought to be recovered. *Kaye v. Grossman,* 202 F.3d 611 (2d Cir. 2000); *Dolmetta v. Uintah Natl. Corp.,* 712 F.2d 15 (2d Cir. 1983); *Albrechta v. Broome County Indst. Development Agency,* __ A.D.2d __, 710 N.Y.S.2d 709, 711 (3d Dept. 2000); *Lake Minnewaska Mountain Houses, Inc. v. Rekis,* 259 A.D.2d 797, 798, 686 N.Y.S.2d 186, 187 (3d Dept. 1999). The third factor is critical, and the plaintiff must show that "*as between the two parties to the transaction* the enrichment is unjust." *McGrath v. Hilding,* 41 N.Y.2d 625, 629, 394 N.Y.S.2d 603, 606 (1977) (emphasis added).

Here, even assuming that Empire has been enriched by earning interest on the withheld funds at Mid-Island's

expense, the Court finds that equity weighs strongly against Mid-Island. The withholding clause of Section 91.4 was invoked by the State after Mid-Island failed to make payments required by law. Mid-Island could have ended the withholding at any time and recovered its funds from Empire simply by repaying its accumulated debts to the State, yet it failed to do so for nearly a decade. In fact, Mid-Island admits in its brief that the withholding provision is intended to serve as punishment for its non-compliance. By contrast, Empire is entirely blameless in the transaction. The regulation required Empire to withhold 10% of Mid-Island's reimbursement, and Empire properly complied with this duty. Other than its assertion that Empire should have paid it interest on the withheld funds, Mid-Island ascribes no malfeasance whatsoever to Empire. Thus, as between the blameless Empire and the delinquent Mid-Island, the Court finds that, as a matter of law, equity favors Empire over Mid-Island in the claim for interest.

Accordingly, it was not error for Judge Holland to grant summary judgment to Empire on Mid-Island's claim for interest based on a cause of action for unjust enrichment.

Mid-Island's claims for breach of fiduciary duty and negligence are quite similar. Mid-Island asserts that Empire became a fiduciary, holding the withheld funds in trust for Mid-Island, and that it breached its duty of care by failing to invest the funds and secure the interest. However, as the Court discussed previously, the Court construes the withheld funds as a trust for the benefit of the State, not for Mid-Island, and to the extent Empire owed a duty to anyone with regard to the funds, it was to the State. Notably, it is the State, not Mid-Island, that determines when the withholding should

begin and when the funds should be released. Moreover, as Judge Holland pointed out, the regulation is silent on whether the withheld funds should generate interest, and Mid-Island has failed to point to any communication it had with Empire in which it requested that the funds be invested. Notably, Empire had the funds in its possession beginning in 1989, yet Mid-Island has not established that it ever requested Empire to pay over the accumulating interest at any time. Mid-Island's failure to do so is strong evidence that no party ever considered Empire to be bound, by regulation, common law duty, or otherwise, to invest the funds for Mid-Island's benefit or to be responsible for interest payments.

Accordingly, the Bankruptcy Court did not err in granting summary judgment to Empire on Mid-Island's state law claims with regard to its claim for interest payments.

CONCLUSION

For the foregoing reasons, the oral decision of Judge Holland granting Empire's motion for summary judgment on Mid-Island's October 6, 1998 complaint seeking an award of interest from Empire on the withheld funds is AFFIRMED. The Clerk of the Court is directed to close this case.

SO ORDERED.

Dated: Central Islip, New York
September 23, 2000

Arthur D. Spatt,
United States District Judge

APPENDIX C — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING THE PETITION FOR PANEL REHEARING DATED AND FILED MARCH 7, 2002

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

ROSEANN B. MACKECHNIE
CLERK

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 7th day of March two thousand two.

Present:

Hon. John M. Walker, Jr., Chief Judge
Hon. Guido Calabresi,
Hon. Rosemary S. Pooler,
CIRCUIT JUDGES,

In re: Mid-island

v

Docket No. 00-5076

A petition for panel rehearing having been filed herein by Appellants Mid-Island Hospital, Inc. and Official Committee of Unsecured Creditors of Mid-Island Hospital, Inc.

Appendix C

Upon consideration thereof, it is

Ordered that said petition be and it hereby is DENIED.

FOR THE COURT
ROSEANN B. MACKECHNIE, Clerk

By: s/ Arthur M. Heller
Arthur M. Heller,
Administrative Attorney